Openness in public procurement markets: Time for a reality check

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In March 2012, the Commission has tabled a proposal for a “Regulation establishing rules on the access of third countries’ goods and services to the EU internal market in public procurement”. A core provision of this Regulation is the so-called “reciprocity” clause which would open the legal possibility for the EU to deny access to its public procurement markets to firms originating from countries with public procurement markets that the EU would feel less open than its own markets.

The supporters of the reciprocity clause argue that such a clause is imposed by the fact that the EU public procurement markets are much more open than those of the main EU partners, and that this clause would improve the EU leverage in future negotiations. These two claims— the EU markets being more open and the EU gaining increased leverage—require a careful review of the facts. This paper provides such a review. It is organised as follows.

• First, it scrutinises the “impact assessment working document” [Commission 2012] attached to the Directive proposal in order to see whether it provides the information justifying credible threats. The paper also argues that the “reciprocity” clause is prone to “privatisation” by a few large and powerful firms— to the detriment of all the other EU firms, with likely net costs for the entire economy of the EU Member States.

The European Parliament hearings on the Commission’s proposal for a “Regulation establishing rules on the access of third countries’ goods and services to the EU internal market in public procurement” offers an opportunity to review two key pillars of the proposal. First, the Directive proponents claim that the EU public procurement markets are much more open than those of its main partners. Second, they assume that the threat of the “reciprocity” clause (allowing the EU to deny access to EU public procurement markets to firms originating from countries with public procurement markets that the EU would feel less open than its own markets) is credible.

The paper provides robust evidence that the EU public procurement markets are definitely not more open than those of its main partners. It first shows that, when one compares what is comparable, the impact assessment working document on which the Directive proposal relies fails to support the EU claim. Moreover, the paper provides a robust and exhaustive evidence (based on National Accounts) of the fact that the EU public procurement markets are often less open than those of its main partners.

The paper goes on to argue that the threat of the “reciprocity” clause is not credible for three, cumulative, reasons. The public procurement markets of some of the EU partners are rapidly becoming bigger than those of the whole EU or than those of the largest EU Member States – meaning that EU firms will lose more than partner firms in the case of reciprocity-based measures and that it will be difficult to build strong coalitions among EU Member States for generating credible threats. The paper also argues that the “reciprocity” clause is prone to “privatisation” by a few large and powerful firms— to the detriment of all the other EU firms, with likely net costs for the entire economy of the EU Member States.

The paper provides two other interesting observations. First, it gives evidence suggesting that the Internal Market in public procurement does not work well. Second, it shows that negotiations in the context of preferential trade agreements (with Japan, the US, Taiwan, etc.) are a much more promising way to improve EU firms’ access to foreign public procurement markets than the reciprocity clause. In addition, such negotiations, if well-conceived, would enormously help the EU to improve the functioning of its own Internal Market.

SUMMARY
rtifying the claim of more open EU public procurement markets. It shows that the impact assessment working document (IAWD) fails to support such a claim.

• Then, it uses a recent database which offers much more exhaustive information than the one utilised by the IAWD. This database provides robust evidence that the EU public procurement markets are often less open than those of its trading partners.

• Finally, it raises the crucial question not tackled by the IAWD: is the EU threat to close its markets credible? In other words, would EU firms not be more hurt by the EU use of the reciprocity clause than foreign firms? The paper shows that the EU threat is not credible for the major EU trading partners.

THE IMPACT ASSESSMENT WORKING DOCUMENT: COMPARE WHAT IS COMPARABLE

The impact assessment working document (IAWD) which is the analytical basis of the Directive proposal consists of a cover text and 11 annexes. Annex 3 entitled “Problem analysis” is the key part of the IAWD since it presents the Commission’s estimates of the level of openness of public procurement markets in the EU as a whole (there is no estimate by EU Member State) and in twelve major EU trading partners.

Table 1 recapitulates the figures of Tables 3 and 7 of Annex 3 which summarises the Annex main findings.

• Column 1 presents the size (in billions of euros) of the total public procurement markets above the thresholds as set by the Government Procurement Agreement (GPA) signed at the end of the Uruguay Round (1995).
Column 2 presents the Annex 3 estimates of the public procurement markets openness based on the legal international commitments taken by the EU and twelve countries, either under the 1995 WTO Government Procurement Agreement (GPA) or under existing preferential trade agreements (as best illustrated by Mexico which is not a Party to the GPA). The openness ratios of these so-called de jure commitments are given by the share (in percent) of the value of the markets considered as open de jure in the total value of public procurement markets above the GPA thresholds.

Column 3 presents the Annex 3 estimates of the commitments taken by the EU with respect to its twelve partners when the “general notes or specific derogations” are taken into account. Specific derogations are targeted restrictions imposed by the EU “because of the disparities in commitments” in 1995 GPA [Annex 3 page 8]. For instance, the US has not been granted access to EU public procurement markets in water, airports services and urban transport (among others) and Japan has not been granted access to EU public procurement markets in electricity and urban transport [General Notes and Derogations from Article III, Appendix I for the EC, Government Procurement Agreement 2003].

Column 4 presents the Annex 3 estimates of the public procurement markets openness of the EU’s partners on a de facto basis. A market is considered as open de facto if “a country does not apply protectionist measures in the public procurement markets that are not open de jure” [Annex 3, methodological box 4]. The de facto openness ratios are measured by the share (in percent) of the value of the markets considered as open de facto in the total value of public procurement markets above the GPA thresholds.

For information sake, column 6 describes very briefly the current situation in terms of PTAs between the EU and the other countries listed.

Column 2 figures are those systematically reported by the proponents of the Directive for justifying the need for such a Directive. Indeed, these figures deliver a strong impression of asymmetry: the estimated openness of the EU public procurement markets (85 percent) is much larger than the openness of most of the EU trading partners (which range from 0 to 75 percent).

However, such a comparison does not compare what is comparable. It systematically over-estimates the EU level of openness and systematically under-estimates the level of openness of the EU’s trading partners:

Column 2 systematically over-estimates the EU openness because it does not take into account the “specific derogations” that the EU imposes on a bilateral basis because of the disparities in commitments. These specific derogations are an integral part of the 1995 GPA. As a result, they are the best definition of the “true” EU commitments. Column 3 takes into account these specific derogations, and shows a drastic reduction in the level of openness of the EU in all the cases but Korea. For instance, the EU degree of openness drops from 85 percent (column 2) to 46 percent (column 3) in the case of the US and to 70 percent (column 3) in the case of Japan.

Column 2 systematically under-estimates the openness of the EU trading partners because it does not take into account the fact that countries do not apply de facto protectionist measures in some public procurement markets. Column 4 shows that taking into account these open market practices drastically increases the true level of openness of all EU partners which then ranges from 24 to 92 percent.

In short, two remarkable lessons can be drawn from Table 1:

• the “true” EU level of openness (including specific derogations) and the “true” EU GPA partners level of commitments (taking into account systematic non-protectionist practices) are generally very similar.

• The level of openness of non-GPA countries is within the range of the “true” EU level of openness (10 to 82 percent).

Comparing what is comparable leads to the conclusion that the IAWD on which the Directive proposal relies fails to support the EU claim to have public procurement markets much more open than those of its partners.
Before looking for more evidence, it is useful to put into perspective the “asymmetry” in the level of openness argued by the proponents of the Directive. Such an asymmetry would imply that the European negotiators (from the Commission and the Member States) would have “badly” negotiated during the Uruguay Round. This is because, during the Uruguay Round, the GPA was not part of the global trade-off among all issues on the table (industrial tariff cuts, agricultural “tarification”, opening services markets, etc.). Rather, it was a standalone piece of negotiations because it was negotiated only among a dozen of “willing” countries, not by all the GATT Members (a “plurilateral” agreement). The logic of standalone trade negotiations imposes that, on the sole issue at stake (in this case, the opening of public procurement markets), every country balances the market access concessions it grants to its partners almost exactly with the market concessions it gets from its partners.

Indeed, the available evidence on the GPA negotiations during the Uruguay Round does not support the hypothesis of a failure of the EU negotiators. The experts who analyzed the 1995 GPA stressed the almost perfect balance of the negotiations between the two largest trading partners in terms of value of the markets opened, with US$ 103.2 billion opened by the US side and US$ 103.3 billion opened by the EU [Schott and Buurman 1994]. Indeed, for reaching such a balance, the US negotiators have had to bring to the table of negotiations 39 US States (including the five largest) and 7 US municipalities (among the 24 largest US towns) in addition to the federal public administrations and agencies.¹

### EU MORE OPEN PUBLIC PROCUREMENT MARKETS? DEFINITELY NO

The conclusion that the EU claim is not warranted is so important that it deserves to be confirmed by evidence based on more robust and exhaustive data. Indeed, Annex 3 recognises the many technical flaws of its approach. Two flaws deserve to be underlined. First, relying on bids operated under the GPA rules cannot provide an accurate view of the “nationality” of the goods and services involved in these bids. A bid can be operated by a French firm which may have recourse to many non-French goods and services, via multiple sub-contracts. And relying on bids cannot provide an accurate view of the final amounts of the bids (the ones that count, the initial amounts being subject to frequent and massive underestimates) nor an accurate view of the real expenses over time.²

But, the most important flaw of the Annex 3 estimate is that a measure of openness of the public procurements based on GPA commitments does not make economic sense. It is equivalent to measuring openness in goods by focusing exclusively on a subset of tariffs which has been subject to past negotiations while ignoring the rest of the tariff schedule left untouched by the deal. Indeed, openness in trade in goods is routinely assessed on the basis of the whole range of products which is described exhaustively in the common tariff nomenclature (Harmonized System). In other words, an exhaustive view of the situation in public procurement markets—not only those under the GPA—is necessary. Without such an exhaustive view, an approach would easily lead to disastrous consequences when combined with the “reciprocity” clause, as shown in section 4.

There is thus a need to find an encompassing and robust definition of public demand that covers every cent spent by a public administration or an entity considered as a public agency—including utility sector bodies—on domestic and foreign goods and services. Foreign public procurement corresponds then to imports of goods and services absorbed by such public demand. National Accounts provide precisely this information on public demand and the associated imports (indeed, Annex 3 mentions the recourse to National Accounts as the most desirable one).

In this context, the recently released World Input-Output Database [Timmer et al., 2012] appears the perfect instrument to do such a test (see Annex 1 and for more details [Messerlin and Miroudot 2012]). It has three key advantages:

- it covers all goods and services,
- it provides individual data for the 14 largest world economies (EU being one) as well as for all the EU Member States, and
- it covers the whole period (1995-2009) since the
Based on the WIOD data, Table 2 provides the “penetration” ratios, that is, the shares of public imports to total demand for public goods and services for each country. It gives these ratios for the 13 individual EU trading partners by the WIOD. In the EU case (EU Member States and EU27), these ratios take into account only the extra-EU public imports, in order to be comparable with the penetration ratios of the non-EU countries. Table 2 gives also those ratios for the “EU2” (the sum of France and Germany) in order to take into account the size effect of public demand since larger countries tend to have smaller penetration ratios (the EU2 combined public demand is very close to the Japanese public demand, hence is the entity the most comparable to Japan).

For the period 1995-2008, Table 2 suggests three observations which re-enforce strongly the conclusions drawn in the first section. These observations are based on comparing public demands of comparable size—first EU27 and US, second EU2 and Japan, and third EU2 and China.

- Graph 1 shows that the EU27 and US penetration ratios have been close from 1995 to 2002, but that, after 2004, the growth rate of the EU penetration ratio has been higher than the US growth rate to the point that the EU27 ratio has been higher than the US one since 2006. In other words, the EU27 has become slightly more open than the US since 2004; that is, at a time when, everything else being constant, the size effect should have rather induced the EU27 to become less open than the US. It is worth noting that the lower growth rate of the US penetration ratio dates from 2003, that is, a few years before the US proposals on the strengthening of restrictions in US public procurement tabled in the aftermath of the 2008 crisis.
GRAPH 1. EU27 AND US PENETRATION RATIOS, 1995-2008


GRAPH 2. EU2 AND JAPAN PENETRATION RATIOS, 1995-2008

Graph 2 shows that since 2002 Japan’s penetration ratios have caught up the EU2 penetration ratios and that Japan is more open than the EU2 since 2006, despite the systematic bias about EU openness when using EU2 aggregates.\(^7\)

Graph 3 shows that China’s penetration ratios are higher than the EU2 ratios for the whole period. Interestingly, it is increasingly higher since 2001, that is, when China’s public demand was catching up at a very rapid pace with EU2’s public demand. In short, the EU2 has become less open than China precisely at a time when the relative size effect should have induced it to become relatively more open.

The main lesson to be drawn from Table 2 and the above graphs is that the EU claim to have more open public procurement markets than its main trading partners is definitely not supported by evidence.

Table 3 allows to turn the attention to the EU Internal Market. It compares the evolution of intra- and extra-EU penetration ratios for the EU27 and EU2.

Table 3 suggests a worrisome evolution for the Internal Market. Since 2002-2003, the intra-EU penetration ratios are decreasing compared to the extra-EU penetration ratios. It is beyond the scope of this paper to explain this erosion. But the many possible reasons (loss of efficiency among EU Member States, badly implemented or inefficient Internal Market rules in public procurement matters) definitely merit attention from top EUMS (EU Member States) policy-makers.
A CREDIBLE THREAT?

The reciprocity clause of the Directive proposal triggers negative dynamics: the fact that foreign markets are closed would allow the EU to close its own markets. In short, protection calls for protection. This is the opposite of the reciprocity approach used during the last sixty years which was built on positive dynamics: reciprocity was defined as a joint and balanced opening of the markets of the trading partners.

That said, what follows focuses on the issue of the value of the threat associated with the reciprocity clause. For argument’s sake, it leaves aside the key lesson from the previous sections—that is, the fact that the EU has lost its main argument for reciprocity since its public procurement markets are not more open than those of its main partners.

Threats have to be credible—if not, they are embarrassing paper tigers. The credibility of the “reciprocity” threat has three main dimensions: with respect to the EU partner, to the EU as a whole, and to every EU Member State (EUMS).

The frequent claim that the reciprocity clause would be mostly used against emerging economies focuses on the EU partner. The problem is that it does not take into account the fast changing balance of economic size and power. For instance, China’s public demand was 7.6 times larger than the EU2 (France and Germany) public demand in 1995, 2.9 times in 2000 and less than 1.3 times in 2009—and it is likely to be bigger today. Hence, the following question: how credible is a threat to close EU mature and slow-growing public procurement markets with the high risk to be subjected to China’s retaliation on its still unsaturated and fast-growing public procurement markets? Clearly, EU firms have much more to lose than Chinese firms from EU threats (and indeed than US, Japanese, Korean or Taiwanese firms which could benefit from the EU-China conflicts).

The EU dimension raises the question of the capacity to build intra-EU coalitions capable of sustaining credible threats. Talking about EU27 (or any kind of aggregation of EUMS) public demand with a partner’s public demand is easily misleading because public procurement markets are fundamentally under EUMS competence. This is a feature which makes the EU very different from the US: the US has very substantial federal public procurement markets, the EU has almost none. For instance, to argue that the EU2 public procurement demand is similar in size to the Japanese public procurement demand does not take into account the interests of each EUMS. Japanese public procurement markets could be considered as closed by French firms and open by German firms (or vice-versa). That makes unlikely the emergence of a strong Franco-German coalition for supporting the threat. This dimension of the credibility threat increases the number of EU partners against which EU threats will not be credible. In particular, EU threats against partners as big as the large EUMS (such as Brazil, India or Russia) have almost no credibility.

The last dimension of the threat credibility is internal to each EUMS. It reveals the heavy risks of “privatisation” of the use of the reciprocity clause by a few and powerful firms, to the detriment of the rest of the economy. For instance, let us assume that a couple of firms from one EUMS claim (rightly or wrongly—that is not the point at this stage) that the partner’s public procurement markets using their products or services are closed. Under the proposed Directive, this couple of firms could obtain the closing of some EU public procurement markets. This action may trigger the EU partner to close its public procurement markets in other goods or services which may be wide open to many firms from the same EUMS—hurting badly the EUMS firms exporting to these open markets, and likely to generate net costs for the whole EUMS economy.

CONCLUDING REMARKS

The paper provides two key lessons. First is that the EU public procurement markets are definitely not more open than those of its main trading partners. Second, the threat associated with the reciprocity clause is not credible for at least the half-a-dozen largest EU trading partners. The threat may thus work only for small countries. But, then, its benefits are likely to be small (the small partners’ public procurement markets are likely to be small) and they have to be discounted by the reputation of a “bully” EU with respect to small countries—a high political price.
These lessons do not mean that the EU should not take some initiatives for more access in public procurement markets. But, the right way to do it is not by relying on a “reciprocity threat” which is largely out-of-reach for the EU. It is by opening and concluding negotiations.

Those negotiations could be held in Geneva, in the context of an enlarged (in terms of countries, sectors, institutions, thresholds, etc.) WTO Government Procurement Agreement. Alternatively or concurrently, they could be included in the negotiations of preferential trade agreements (PTAs). These two tracks are not so different. As suggested in Table 1, the EU “true” level of commitments (taking into account the specific derogations) under the 1995 GPA varies a lot according to EU trading partners. In fact, the good scores achieved by Korea or Mexico in Table 1 are partly related to their preferential trade agreements with the US and the EU. Moreover, the scoping exercise between the EU and Japan has shown how the negotiating process should be used in the years to come. Rather than being a mere confrontation of the two parties, it should be the opportunity for both sides to think about their own regulatory weaknesses, and to use the negotiations as a way to reform their own economies. In other words, bilateral negotiations can be a crucial way to improve regulatory quality in both negotiating parties, and, in the case of the EU, offers to the EUMS priceless opportunities to promote the much needed deepening of the Internal Market in public procurement matters.

REFERENCES


ANNEX 1

The World Input-Output Database provides a global (world) matrix of inter-country and inter-industry transactions. Therefore, we can distinguish between extra-EU and intra-EU imports when it comes to public demand. The methodology used to construct the WIOD tables is explained in Timmer et al. (2012). We calculate public demand as the sum of:

- Final consumption expenditure by governments
- Intermediate consumption by industries in public sectors

The public sectors are defined as: ‘electricity, gas and water supply’ (100%), ‘post and telecommunications’ (50%), ‘public administrations and defence; compulsory social security’ (100%), ‘education’ (100%) and ‘health and social work’ (100%).

ENDNOTES

1. I would like to express my deep thanks to Sébastien Miroudot for his remarks and comments.

2. The IAWD presents the potential de jure commitments that the EU would take under the new GPA under negotiations in the WTO if these negotiations were successful. This information is not reported in Table 1 since the IAWD provides no equivalent estimates for the EU’s trading partners.

3. These figures are those related to US commitments with respect to the EU.

4. In this context, it is interesting to note that all the signatories (including the EU) of the new WTO GPA have recently agreed that a huge effort should be made to collect much better data than the existing ones and to make their notifications much more comparable [Anderson 2012]. Indeed, the current methodologies used for estimating the GPA-covered public procurements are so different that it is impossible to try to reconcile them [Anderson et al. 2011, in particular footnotes 21 to 23].

5. This intrinsic flaw of relying on GPA commitments is amplified because they are defined not only in terms of economic activities (products and services) but also in terms of thresholds for bids and of an endlessly wide range of public entities included in the commitments.

6. Differences between the EU15 and the EU27 are small enough to use the EU27 for the whole period for the sake of simplicity.

7. The EU2 public demand is an aggregated figure of two economies which, individually, are significantly smaller than Japan (Germany and France are 0.6 and 0.5 times the Japanese economy). Hence, the EU2 penetration ratios are systematic over-estimates of what would have been the penetration ratios of a fully unified EU2 economy since aggregating these two economies does not eliminate the fact that decisions have been taken in the context of these two notably smaller economies.
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